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SUBJECT: MEXICO: LATIN AMERICA-CARIBBEAN BIOFUELS INITIATIVE

REF: SECSTATE 164558

¶1. Summary. Mexican officials, private organizations and energy research centers believe that the country's agricultural production is appropriate for ethanol and bio-fuel manufacturing, but with output of only 45 million liters per year, significant investment and infrastructure development will be necessary before Mexico can count on ethanol for a significant share of its fuel demand. Nevertheless, Pemex officials report the company is looking at options to produce a 10% ethanol fuel. The Mexican Congress is considering two measures to promote ethanol and biofuels, and investors have begun building some ethanol facilities. End summary.

¶2. Mexico produces 45 million liters/year of ethanol and imports an additional 119 million liters/year to supply its chemical and pharmaceutical sectors. In a recent speech to energy industry representatives, Energy Secretary Fernando Canales noted that the Mexican oil and gas monopoly, Pemex, would develop an integrated program to blend ethanol with gasoline sold throughout the country. Pemex recently invested USD 4 million in a first step to add the necessary equipment to the company's 6 refineries and 17 gasoline distribution centers.

¶3. Nonetheless, Mexico is limited in how far it can take the program due to its limited ethanol production capacity. Currently Mexican ethanol production is all slated for non-fuel uses. According to the Mexican press, two private investment projects supported by the national development bank are moving ahead in Sinaloa state to produce ethanol from corn, one project in Tamaulipas state will produce ethanol from sorghum, and two projects in Veracruz state will produce ethanol from sugar cane.

¶4. Along the same lines, the Mexican Economy Secretariat announced a public-private program in January 2006 for the domestic sugar industry to examine construction of ethanol plants. Press reports indicate that Mexican sugar industry representatives, concerned about competition from high fructose corn syrup, are looking to ethanol production as a potential savior for the industry.

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Investment Climate  
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¶5. There is no specific bio-fuel legislation in place in Mexico, but the Mexican Congress has entered the debate, and there are now two proposed pieces of legislation to establish the necessary legal framework for the Mexican Energy Secretariat (SENER) to move ahead on bio-fuels.

(A) Proposed Law for the Use of Renewable Sources of Energy -- The proposal includes the creation of a trust fund that will allow "renewable energy sources" to provide 8 percent of national electricity generation by 2012. This proposed law defines bio-fuels as "liquid or gas fuels, such as ethanol, methanol, bio-diesel and methane gas, as long as they are produced from biomass, or non-toxic and safe organic residues." Within this generic trust fund, a specific support would be created to cover any differentials between the cost of production and market prices for bio-fuel.

(B) Proposed Law for the Development and Promotion of Bio-fuels -- In this proposal, bio-fuels are defined as "ethanol and biodiesel fuels that are produced from commodities or agricultural products." The law calls for phasing in a specific target for percentage biofuel or ethanol for all Mexican gasoline.

¶6. Both proposals are under debate in the current session of Congress. As a result of the greater attention given to ethanol in recent months, the GOM has decided to analyze for itself the true potential of bio-fuels. With support of the Interamerican Development Bank and the German government (GTZ - German Technical Cooperation), SENER is carrying out feasibility studies for ethanol and bio-diesel. Those studies were to have been completed in the last several weeks, though the Embassy has not yet been able to obtain copies.

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Energy Sector  
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¶7. Despite these first steps, Article 27 of the Mexican Constitution, reserves production of crude oil to Pemex.

While initial reading of the constitution does not indicate that ethanol production would be similarly restricted, the lack of legal framework and Pemex's de facto position as the only gasoline distributor and retailer in Mexico suggests that some regulatory and legislative work will be required to allow legal clarity for large-scale ethanol blending to move forward, a position confirmed by industry experts.

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Agriculture Industry  
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¶8. Many private organizations and energy research centers in Mexico believe that the country's agricultural production is particularly appropriate for ethanol and bio-diesel. However, none of the 8 percent of the nation's energy consumption generated from biomass is related to fuel for transportation. The main sources of bio-energy used are sugar cane bagasse (92 Petajoules -- used for the generation of electricity and heat in the sugar cane industry) and wood (250 Petajoules -- used for heating and cooking).

¶9. The transformation of the sugar industry will be another factor that the new government has to consider in its overall bio-fuel policies. Mexican industry and government officials recognize the need to diversify the sugar industry. Currently, almost all sugar cane production goes into the production of sugar. The sugar industry is pushing the government to develop a bio-ethanol industry as a key part of diversification, and the current Sugar Law already has some provisions towards such diversification. However, many have pointed out that successful development requires substantial investment in plants and infrastructure as well as the participation of Mexico's energy sector. Some local governments are also indicating that they will provide some "supports" to produce ethanol based on sugarcane. However, since the Sugar Law is still an uncertain legal framework, there is no clarity about the policy and pricing of sugar cane for ethanol production purposes.

¶10. Mexico currently does not produce enough corn to meet domestic demand, although some regions do produce a surplus. That being the case, it is unlikely that Mexico could effectively use corn as an ethanol feedstock.

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